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Bangladesh Development Update



*Poverty Reduction and Economic
Management, South Asia Region*

The World Bank

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Bangladesh Development Update

Summary

Recent Economic Developments

1. **GDP growth in fiscal 2013 is likely to fall to around 6 percent compared with 6.3 percent in fiscal 2012.** Weak exports and investments resulting from the impact of the euro-area crisis, domestic supply constraints, and intensified strikes and unrests underpin the growth slowdown. Strong remittances and robust service sector performance are expected to help maintain growth at a still healthy level. Increasingly fragile political stability does not bode well for revival of investment needed to accelerate growth.
2. **A broad-based declining inflation trend appears to be gaining ground.** Average (twelve-monthly-moving) inflation has declined steadily over the past ten months, from a peak of nearly 11 percent in February 2012 to 8 percent in March 2013, reflecting declines in both food and non-food inflation. Year-on-year inflation declined to 7.7 percent in March 2013, compared with 10.1 percent in March, 2012. Favorable international commodity prices, a stable exchange rate and monetary tightening contributed to lowering inflation.
3. **The overall external balance continued to remain positive with a record increase in reserves to over US\$14 billion** (equivalent to 4.4 months of imports) by end-March 2013. The rapid increase in reserves reflects both the economy's strengths in attracting remittances and external assistance, and weaknesses in the form of depressed domestic demand growth leading to a decline in imports.
4. **Financial development is riding a bumpy road.** Bangladesh slipped one notch in the Financial Development Index, and is now ranked 57th out of 62 economies. Stability of the banking sector deteriorated as a result of corporate governance failures, non-bank institutions are not doing any better, and the confidence deficit in the capital market has persisted.
5. **Prudent monetary and fiscal management contributed to sustained growth and macroeconomic stability.** Monetary policy has gained credibility by adhering to the monetary program target for the first half of fiscal 2013, but the shift towards an expansionary stance for the second half, albeit modest, may be premature. Fiscal policy is on track to maintain prudent levels of overall deficit and improve the composition of deficit financing towards lower monetization and domestic bank financing, with a rise in the share of concessional external finance.
6. **Progress on structural reforms has been slow.** The government has undertaken a reform program supported by the International Monetary Fund (IMF)'s ECF. Structural measures under the program aim to modernize the tax regime, bolster fiscal controls, strengthen financial sector oversight, and improve the trade and investment climate. Policy undertakings have been broadly in keeping with program commitments under the ECF, but a number of structural benchmarks were not met, either due to delays in completion or the need for more time to make legislative changes or reach internal policy consensus.

Development Progress

7. **Progress on the Millennium Development Goals (MDGs) has been remarkably successful, with Bangladesh managing to bend the arc of poverty reduction to a notable degree and share prosperity in the 2000-10 decade far better than in the preceding ten years.** Bangladesh has already achieved 3 of the 28 MDG targets, and is on track with another 11, needing to give attention to the remaining 14 (as of 2011). Poverty reduction during 2000-2010 has been remarkable. The country was one of the 18 “highlighted” countries of the South that made greater gains on the Human Development Index (HDI) between 1990 and 2012 than expected from their previous performance on the index. Human development has also been relatively more inclusive in Bangladesh.

8. **The number of poor declined by 15 million in the first decade of the new millennium, compared with a decline of 2.3 million in the preceding decade.** There have been improvements too in several dimensions of non-consumption-based welfare. Inequality has stabilized and there has been some regional convergence in consumption poverty levels in the second half of the 2000-2010 decade. Growth of labor income and a declining dependency ratio were the main contributors to poverty reduction in this period. Nevertheless, Bangladesh continues to have highest rate of poverty relative to its South Asian counterparts, measurable by continuing low real per-capita GDP.

9. **Further depth and breadth needed in development progress.** Even in the face of outstanding achievements in reducing poverty and childhood underweight at the national level, achieving all of the hunger MDGs remains a challenging undertaking for Bangladesh. The country faces a tough road in addressing certain pockets of poverty that lag far behind national averages (in urban slums, the hill tracts, coastal belts and other ecologically vulnerable areas). Enrolling in schools the last 10 percent of hard-to-reach children, ensuring quality of education, and promoting gender equity in tertiary education remain major challenges. Threat of climate change could also diminish hard-earned benefits from years of growth and development.

Opportunities for Development

10. **Bangladesh has a historical—but time-bound—opportunity to reach 8 percent growth.** International investors are looking for low-cost manufacturing in Bangladesh. The country is poised to exploit the long awaited “demographic dividend” with a rising share of working-age population. Bangladesh’s growing and abundant labor force currently is highly under-utilized. On the other hand, Bangladesh’s competitors are becoming expensive places in which to do business. Bangladesh is much more competitive in labor costs compared to India, Indonesia, Vietnam and Cambodia. Taking advantage of this low-cost competitive edge, could make Bangladesh into “the next China”. But, if Bangladesh fails to act soon, others will take the markets China is vacating because of dynamic comparative disadvantage.

11. **Bangladesh has the potential to capture at least 15 million jobs.** Recent reports (e.g., McKinsey/USAID) have shown that the productivity of Bangladeshi workers is on par with those of China in well-managed firms, with their wages being five times lower than their Chinese counterparts (and half those of Vietnam). Bangladesh’s unique competitive position comes as China is outsourcing 80 million jobs from labor-intensive industries. Bangladesh offers promising opportunities for investment, especially in labor-intensive industries. The government is actively seeking foreign investment, particularly in energy and infrastructure sectors. It is offering a range of investment incentives under its industrial policy and export-oriented growth strategy, with few formal distinctions between foreign and domestic private investors.

An Agenda for Action

12. **Where will Bangladesh's good jobs come from?** A good job is the best form of inclusion. The experiences of other countries suggest that the number of people dependent on agriculture will have to shrink if per-capita incomes in agriculture are to go up substantially. Bangladesh's challenge is to create the conditions for faster growth of productive jobs outside of agriculture, especially in organized manufacturing and services, even while improving productivity in agriculture. The promise of rising to the challenge is decades of strong, inclusive growth. The most critical challenge to productive job creation is to raise the investment rate by at least 5 percentage points of GDP, a precondition for accelerating growth by 1.5- 2.0 percentage points. Bangladesh under-invests by more than 6 percent of GDP compared with Asian norms.

13. **Bangladesh's ability to attract investment and create jobs has been hampered by:** (i) Lack of space in well-located industrial zones; (ii) Expensive financing, especially in trade; (iii) Insufficient power and transport infrastructure; and (iv) Limited promotion of the country's advantages. With the following four initial actions, the government can begin to tackle these constraints and open the door to seize a historic opportunity of creating 15 million jobs over the next decade:

- The Bangladesh Economic Zones Authority (BEZA) to dedicate 40,000 acres for economic zones;
- The PPP Office to manage the tendering for much-needed infrastructure;
- The Bangladesh Bank to act to reduce the cost of trade finance, and;
- The Board of Investment (BoI) to actively promote Bangladesh to investors.

Outlook and Risks

14. **Outlook is heavily dependent on whether Bangladesh successfully seizes opportunities and manages risks.** Export product and market diversification as well as diversification of the main migrant labor destination countries would provide the wherewithal for accelerating economic growth. Experience from other countries suggests that export diversification is associated with generally strong economic performance. Current instability in the Middle East and North Africa may have negative consequences for Bangladeshis living and working in those regions, which would hamper their ability to earn and remit money back home.

15. **Recovery in the euro area and the United States will be most critical for Bangladesh.** Global growth is projected to increase during 2013. The near-term outlook for the euro area has been revised downward. Activity is now expected to contract by 0.2 percent in 2013 instead of expanding by 0.2 percent. Risks of prolonged stagnation in the euro area as a whole will rise if the momentum for reform is not maintained. Growth in the United States is forecast to average 2 percent in 2013, rising above trend in the second half of the year. The projections are predicated on the assumptions that the fiscal sequester from March 1 2013 will have a relatively small adverse impact on GDP growth.

16. **There is a downside balance of risks in the near term.** The readymade garments (RMG) industry is suffering from a severe image crisis in the international markets because of concerns about labor safety arising from fire incidents in two garment factories. This led the US and EU to rethink the Generalized System of Preference (GSP) facilities provided to Bangladesh. Sustainability of the recovery in remittance growth is subject to downside risks because of the uncertainties relating to manpower export prospects. An immediate hindrance to the acceleration of growth is the unprecedented political complexity that Bangladesh appears to have entered.

17. **Should these risks materialize, policy adjustments will have to be primarily through exchange rate and fiscal channels.** At the same time, monetary policy will have to remain sufficiently restrained to contain inflation and maintain reserves. In the near term, a further escalation of political tensions and deterioration in the financial condition of state-owned commercial banks pose the largest risk that may affect growth prospects and public finances.

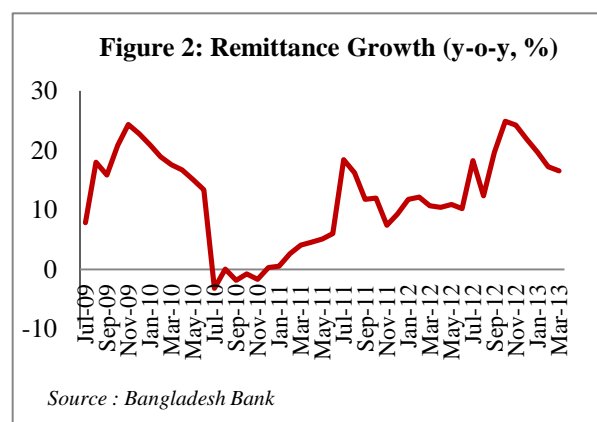
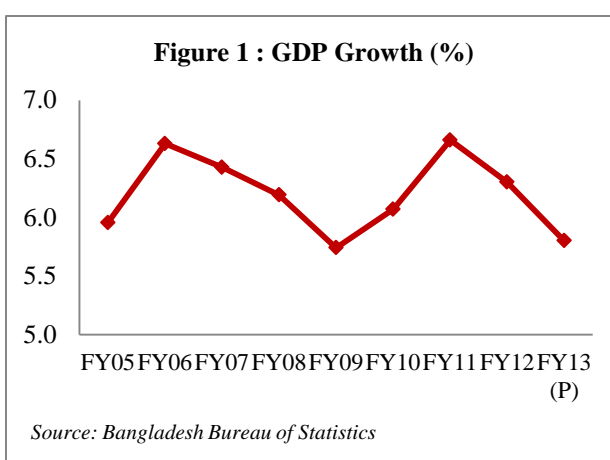
Recent Economic Developments

GDP growth in fiscal 2013 will likely fall short of the fiscal 2013 Budget target (7.2 percent), but is still expected to be a healthy 5.8 percent, roughly on par with recent years. The slight slowdown from fiscal 2012 (6.3 percent) will likely be due to weak exports and investments because of the adverse impact of the euro area crisis, domestic supply constraints, and political uncertainties in the run up to tenth parliamentary elections likely to be held in early 2014. On the other hand, strong remittance and a robust service sector performance will likely help cushion the slowdown. Favorable international commodity prices and monetary tightening have contributed to lowering inflation. Looking ahead, the increasingly fragile political environment does not bode well for revival of investments needed to accelerate growth.

Resilient (but slower) growth recently

18. Notwithstanding some positive signs, most economic indicators point to slower economic growth in fiscal 2013 from the previous year. Domestic consumption demand has been subject to two opposing forces:

- Agricultural output growth, the main driver of rural consumption growth, is likely to remain weak, despite good harvests, primarily because of stagnant cereal crop production. The Department of Agricultural Extension has set the rice (*aus*, *aman*, and *boro*) and wheat production targets at 2.37 million metric tons (MT), 13.3m MT, 18.76m MT and 1.03m MT respectively. The United States Department of Agriculture marginally lowered its production forecast for Bangladesh to 33.8 million MT, about the same as last year's production, to account for crop damage due to flash floods in the north western region and the unusually foggy and chilly weather in December-January which is likely to have had a negative impact on the planting of two major winter crops: *boro* paddy and wheat.¹
- The depressing effect of weak agricultural growth on consumption demand is likely to be reinforced by negative wealth effects resulting from deflating stock market, housing, and land price bubbles. The perceived wealth loss was 20 percent of GDP from the stock market alone.² Millions of households across Bangladesh invested their savings through unregulated multi-level marketing companies (such as Destiny, Unipay 2, and Jubok) which promised high returns and essentially invested in land. With land prices stabilizing or even declining, these investments are likely to sour, with major wealth



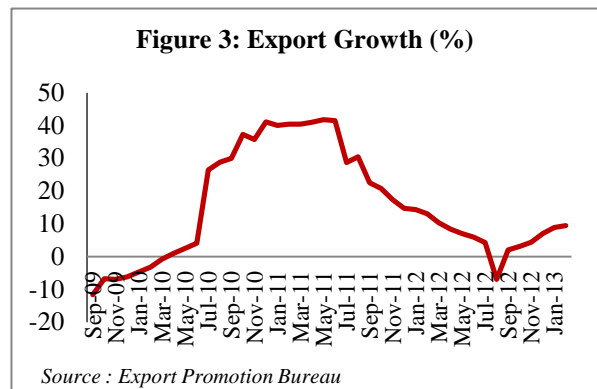
¹ Their planting periods are December to mid-February and November to mid-January respectively.

² A. Mansur (2013), *Investment and Growth—Why Bangladesh Is Missing the Targets?* Policy Research Institute.

loss for millions of households.

- *On the other hand, growth in remittance has picked up, stimulating both rural and urban domestic consumption.* Remittance grew by 16.6 percent during the first nine months of fiscal 2013, compared to the same period of fiscal 2012 (Figure 2). The increased inflow of remittance can be attributed to a rise in outflow of workers and depreciation of the taka in fiscal 2012. Bangladesh sent 691 thousand workers abroad in fiscal 2012 compared to 439 thousand the year before.³ Expansion of formal channels for sending remittance has also contributed to this growth.⁴ The government projects remittance to reach US\$ 14.7 billion in fiscal 2013, a 15 percent increase over fiscal 2012;⁵ Bangladesh is on track to attain this target, assuming remittance grows by 10.5 percent or more during the last three months of fiscal 2013 compared to the same period last year.

19. **Export growth is recovering, but is projected to remain below the last five years' average 14.4 percent growth** (Figure 3). While overall export growth was sluggish in the early part of fiscal 2013, it has since risen steadily. During the first eight months of fiscal 2013 (July-Feb), exports grew by 9.4 percent compared to same period in fiscal 2012. Ready-made garments (RMG) continue to dominate export growth, growing by 10 percent in fiscal 2013 (July-Feb) compared to the same period last year. Year-on-year, export of knit-RMG grew by 6.5 percent while woven garments grew by 13.4 percent. Growth in export earnings came mainly from growth in export volume—woven and knitwear grew in volume by 16.7 percent and 13.5 percent respectively in fiscal 2013 (July-Dec) compared to the same period of the previous year. Although the export of non-RMG manufacturing items such as leather, jute products, footwear, etc. have exhibited an impressive growth trend, the total share of non-RMG exports has been stagnant, at around 20.6 percent.



20. **Weak demand in the EU and US markets mainly account for below-par export growth performance so far.** Bangladesh exports are heavily concentrated in these two markets—71.7 percent of total exports in the first eight months of fiscal 2013. Exports to the EU and US posted growth of 6.5 percent and 4.7 percent respectively during this period. There are some signs of market diversification emerging as export share of markets other than EU and US increased to 28.3 percent in fiscal 2013 (July-Feb) from 26 percent in fiscal 2012 (July-Feb). Cash incentives provided by the government and proactive market exploration efforts by the export associations appear to be contributing to the emergence of new apparel exporting destinations such as Russia, Japan, South Africa, Brazil, and China.⁶

³ See *Bangladesh: Towards Accelerated, Inclusive and Sustainable Growth—Opportunities and Challenges*, June 2012, World Bank, Washington, D.C., for econometric evidence on the linkage between the stock of migrants and the level of remittances.

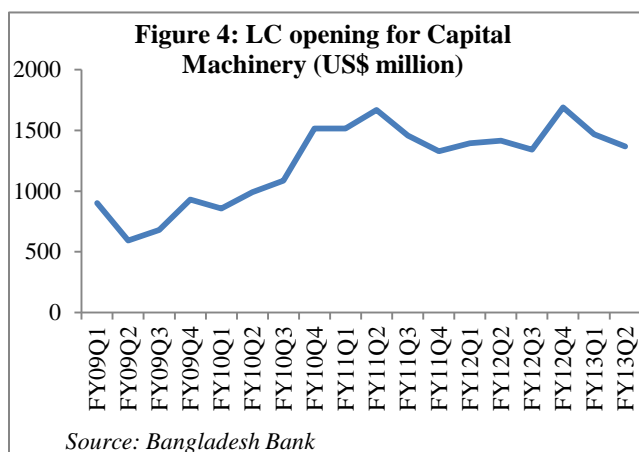
⁴ The increasing options in formal channels are also decreasing the cost of sending remittance, which is encouraging migrants to send more in formal rather than informal channels. Currently, Bangladeshi banks have 927 drawing arrangements with international money transfer organizations such as Western Union, Money Gram, etc. The Banks also have 26 exchange houses abroad to help workers send home remittance. Meanwhile, 27 local NGOs are working as distributors for Bangladeshi banks, eight of which are working with the telecom operators to receive remittance in distant areas of the country. Source: Bangladesh Bank.

⁵ Monetary Policy Statement, January-June 2013, Bangladesh Bank.

⁶ RMG exports record robust growth for market diversification, *The Financial Express*, January 22, 2013.

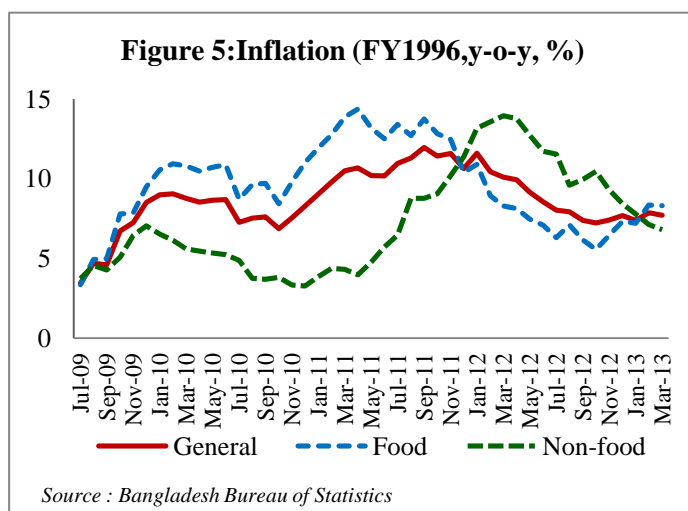
21. **Investment remains stagnant.** The increase in investment required for 7-plus percent output growth is unlikely in fiscal 2013 due primarily to the weak global economy and energy and infrastructure gaps. During the past two decades, the level of investment has been the primary driver of real GDP growth in Bangladesh. However, investment performance has been short of the government's Sixth Five Year Plan (SFYP) target by 1.4 percentage points of GDP in fiscal 2012. This shortfall is likely to widen further in fiscal 2013 due to shortfalls in both public and private investment. The sharp decline in opening of letters of credits for capital machinery is a manifestation of this trend (Figure 4).

22. **The construction sector is suffering from two major weaknesses.** Firstly, the unprecedented recent 400-500 percent surge in urban land and apartment prices has essentially put them out of reach for most households, thereby depressing sales and resulting in a buildup of unsold apartments (a record high inventory of more than 22,000 apartments), leading to slower real estate construction activity. Secondly, major public sector or Public Private Partnership projects are either on hold (Padma Bridge, Dhaka-Mymensingh four lane highway, and Dhaka elevated express way) or progressing very slowly (Dhaka Chittagong highway, Kuril flyover and Purbachol 300 feet road).⁷



Generally steady decline in inflation

23. **A broad-based decline in inflation appears to be gaining ground.** While the overall inflation rate has been rising over the past three years, it has shown signs of abating recently. The annual average inflation target for fiscal 2012 was set at 7.5 percent. However, general (annual average) inflation reached 10.6 percent that year, compared with 8.8 percent in fiscal 2011. The rise was driven largely by non-food inflation. Food inflation started to slow somewhat from January 2012, after the bumper *aman* harvest. Non-food inflation has been on the rise since July 2011, due mainly to expansionary monetary and fiscal policies, the upward adjustment in the administered prices of fuel and electricity, and falling value of the taka against the US dollar, leading to imported inflation.



24. **Over the past thirteen months, inflation (twelve-month-moving average) has fallen from a peak of nearly 11 percent in February 2012 to 8 percent in March 2013.** Year-on-year inflation declined to 7.7 percent in March, 2013 compared with 10.1 percent in March 2012 (Figure-5). This decline has been due largely to lower food price inflation, rice in particular. The price of coarse rice in the

⁷ A. Mansur (2013), *Investment and Growth—Why Bangladesh Is Missing the Targets?* Policy Research Institute.

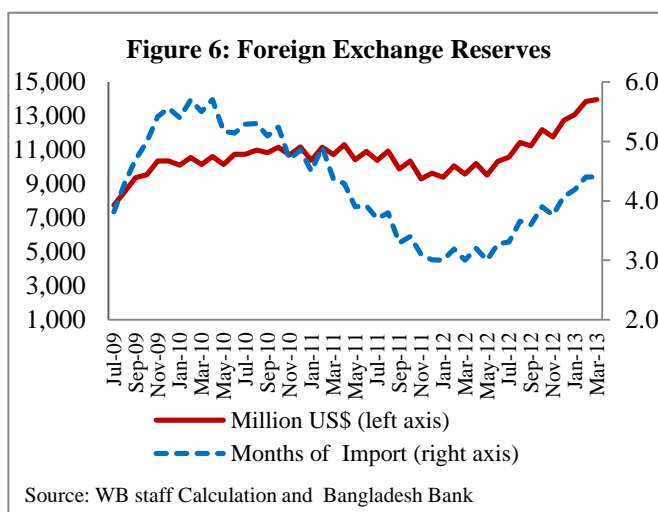
domestic market stabilized at around Tk 28-29 per kg and has remained stable for most of fiscal 2013 so far. Favorable global commodity price trends and comfortable food stock of the government helped to stabilize the food grain prices and thus contain domestic food inflation.⁸ The policymakers, however, face the dilemma of keeping rice prices within reasonable limits from a consumer point of view while ensuring producer incentives. This currently is a major policy challenge for the government.

25. **Recently a decline in average non-food inflation has also contributed to the declining inflation trend.** Point-to-point non-food inflation has declined from a peak of 13.96 percent in March 2012 to 6.8 percent in March 2013. Point-to-point food inflation fell from 10.9 percent in January 2012 to 5.6 percent in October 2012 before rising to 8.3 percent in February-March 2013 because of cost-push factors (rise in transport costs). Based on these trends the fiscal 2013 CPI average inflation target of 7.5 percent announced in the fiscal 2013 Budget may still be achievable if the modest monetary tightening implemented in the second half of 2012 is continued; global commodity prices remain stable, domestic supply chains are not disrupted by political unrest, and the monetary effects of the sharp increase in remittance inflows are sterilized.

Improved external balances

26. **The overall external balance continued to remain positive with a record increase in reserves.** Despite a moderate growth in exports, the overall balance recorded a surplus of US\$ 2.9 billion in the first seven months of fiscal 2013 compared to deficit of US\$ 813 million in the same period of the previous fiscal. The surplus in the overall balance is primarily due to both improving current and financial account surplus. The current account in fiscal 2013 (July-Jan) recorded a surplus of US\$ 821 million compared to deficit of US\$ 1.3 billion in fiscal 2012 (July-Jan) while the surplus in the financial account increased from \$1.7 billion in fiscal 2012 (July-Jan) to US\$1.8 billion in fiscal 2013 (July-Jan).

27. **Contraction of imports and robust growth in remittance contributed to this increase in the current account surplus.** Imports declined by 3.3 percent in the first seven months of FY13 compared to same period of FY12. The decline in import was broad based though import of food and consumer products show relatively high rate of decline. The contraction of import can be attributed to lower oil prices, moderate growth in exports, considering the heavy import content of RMG exports, and policy tightening by the government. Robust growth in remittances lead to a reserve of around US\$ 14 billion by end-March, 2013 (after ACU payments) which is equivalent to 4.4 months import payment (Figure-6).



28. **The increase in reserves and stable BOP situation stabilized the exchange rate.** The taka/US\$ exchange rate has stabilized since early 2012, allowing increased purchase of foreign exchange by Bangladesh Bank (BB) to rebuild reserves (Figure 6). The taka's value, which had fallen by around 15

⁸ For details on food stock management see Center for Policy Dialogue, *Analytical Review of Bangladesh's Macroeconomic Performance in FY2013*, January, 2013.

percent against the US dollar in the twelve months preceding mid-January 2012 reached a stable level at about Tk 84/US\$ in February 2012. In the thirteen months since, the taka has appreciated by around 7 percent against the US dollar. The BB is committed to continue to support a market-based exchange rate while seeking to avoid excessive volatility. The BB's desire for a stable foreign exchange market will need to be balanced against its ability to properly sterilize market interventions.

Stability of the financial sector is at risk

29. **Financial development is riding a bumpy road.** Bangladesh slipped one notch in the Financial Development Index, and is now ranked 57th out of 62 countries.⁹ It continues to score quite low in the institutional and business environment category, and has also declined in the financial access category. However, its performance in financial intermediation has improved. Hong Kong was the top-ranked country in the index, while Venezuela was at the bottom. India and Pakistan, two other South Asian nations covered by the index, have slipped by four and three slots to 40th and 58th positions respectively.

30. **The stability of the banking sector deteriorated in 2012.** Financial soundness indicators suggest some backsliding in asset quality across most types of banks. Overall non-performing loans (NPL) rose from 6.1 percent to 8.8 percent. Moreover, provisions fell from 67.4 percent to 51.5 percent of NPL, with the provisioning shortfall rising to 8.3 percent of total provision requirements. The average Capital Adequacy Ratio (CAR) declined from 11.4 percent in 2011 to 10.5 percent in 2012 and seven banks out of 47 failed to maintain the required CAR of 10 percent. Growth in deposits fell from average rates of 20.5 percent to 19.8 percent. In response, banks slowed their credit growth which reduced their credit-to-deposit ratio (CDR) to 78 percent from the high of 86 percent at the beginning of 2012. Stress testing for July-September 2012 affirmed that banks are susceptible to credit and market risks, but resilient to shocks such as changes in interest rates and exchange rates.

31. **The solvency of the state-owned commercial banks (SCBs) worsened considerably during 2012.** Weak internal controls, poor corporate governance, and slackening of credit standards resulted in irregularities in loan approvals causing the SCBs to classify more than Tk 40 billion as non-performing loans, thereby raising their NPLs to 17.7 percent by September 30, 2012, up from 12.1 percent in March. The SCBs are frequently failing to maintain the cash reserve requirement (CRR) of the BB due to the liquidity crisis that ensued after the loan scams. According to the BB, most of these state-owned banks are now meeting their daily expenses by borrowing from the call money market and from the liquidity support facility of the BB in the form of the special repurchase agreement (repo). As a result of this liquidity crunch, the SCBs have virtually stopped sanctioning new loans.

32. **The non-bank financial institutions (NBFIs) are not doing any better.** Eleven NBFIs out of 22 are yet to meet the revised minimum capital requirement of Tk 1 billion that kicked in on December 31 2012. The NPLs of the NBFIs had also risen to 7.4 percent by September 2012, from 6.3 percent in June 2012. Only five NBFIs showed profits in the first nine months of 2012, with the remainder (17) in the red.

33. **Confidence deficit persists in capital markets.** The “market stabilization effort” did not work and the stock market lost 1,544 points in 2012 to close at 4,573. Investors lost confidence and the daily average turnover declined by 63.7 percent. However, even in the depressed atmosphere in the capital market, 14 companies and mutual funds listed on the bourses in 2012, which mobilized nearly Tk 16

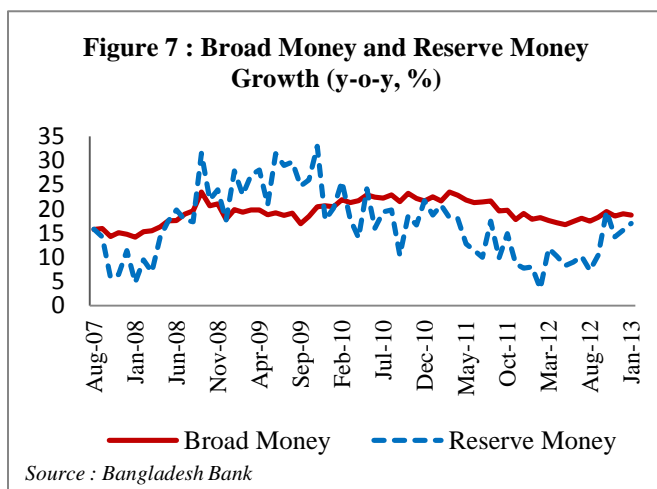
⁹ The index is prepared by the World Economic Forum by analyzing drivers of financial system development of 62 countries across the world. Measures of financial development are captured across the seven pillars of the index and then the variables for measuring the effects of programs and reforms are classified under three broad categories: (1) Institutional and Business Environment; (2) Financial Intermediation; and (3) Financial Access.

billion by offloading 1.05 billion shares and units. But not all of the scrips received a satisfactory response: the four mutual funds and the companies that offered their IPOs at a premium, but without the backing of corresponding fundamentals, got a very poor response. Notwithstanding these injections, the total market capitalization has fallen by 12.7 percent.

Prudent monetary and fiscal management contributed to growth and macroeconomic stability

Monetary policy has gained credibility by adhering to the monetary program target for the first half of fiscal 2013, but the shift towards an expansionary stance for the second half, though modest, may be premature.

34. **Monetary growth rates were broadly on track in the first seven months of fiscal 2013** (Figure 7). Reserve money growth and growth of net domestic assets of the BB remained close to program targets agreed by the government as part of the IMF Extended Credit Facility (ECF) program. The 18.7 percent broad money growth through January 2013 was on a path towards achieving the 18.3 percent target for end-March. The overshooting of the monetary target earlier was due to very sharp increase in Net Foreign Assets (NFA) stemming from the BB's interventions to siphon off excess supply of dollars to prevent a large appreciation of taka.



Domestic credit growth has been on the program path aided by the restrained growth in public sector credit. Private sector credit growth was initially above the program path, but later fell below the BB program level of 18.3 percent. However, the 14.8 percent growth in private credit through January 2013 is close to the 15 percent average private sector credit growth in emerging Asian countries.¹⁰

35. **Conduct of overall monetary policy in fiscal 2013 so far has been consistent with prudential norms.** Money markets tightened in 2012 with increase in money market rates and treasury yields reaching positive territory in real terms. This has been consistent with earlier repo rate hikes by the BB; furthermore, limiting monetization of fiscal deficit has helped restrain growth of net domestic assets. The BB continued to restrict directed liquidity support to primary dealer banks and meet discretionary repo needs at the higher 300 bps penalty rate. Liquidity injected through foreign exchange purchases induced by strong remittance inflows was only partially sterilized by the reactivation of auctions of 30-day central bank bills from November 2012. The BB has committed to strengthen the transmission of monetary policy by strengthening domestic debt management, including promoting greater use of the new secondary market trading platform for government securities and the active trading of new shorter dated government instruments. The Ministry of Finance amended the bond:bill ratio from 80:20 to 50:50. This has significantly improved the appetite for government securities.

36. **Bangladesh Bank has shifted the monetary stance towards somewhat greater accommodation in the second half of fiscal 2013.** The monetary policy stance announced for the second half of the fiscal year seeks, on one hand, to ensure that the credit envelope is sufficient for private investments to support the attainment of the government's real GDP growth target for fiscal 2013 while, at the same time, keeping it consistent with the targeted 7.5 percent average inflation rate for fiscal 2013.

¹⁰ Bangladesh Bank, Monetary Policy Statement, January-June, 2013.

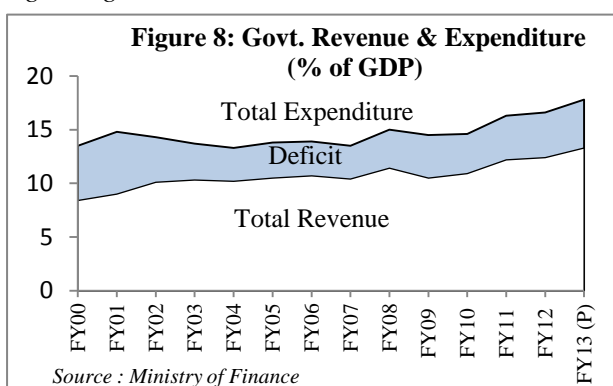
Although the prevailing levels of policy rates were considered to be broadly appropriate, the BB decided to reduce all repo rates by 50 basis points effective immediately. The BB also revised its monetary program with a broad money growth target of 17.7 percent by June 2013 compared to the MPS half-yearly target of 16.5 percent, and a revised private sector credit growth envelope of 18.5 percent by June 2013 compared with the original program target of 18 percent.

37. **Maintaining a relatively restrained monetary policy was warranted because the nonfood inflation rate is still not firmly entrenched in the single digits.** Furthermore, the argument that more space is needed for private credit to boost investment overlooks the fact that efforts to boost economic activity through easy credit, a policy pursued by the BB until end-2011, did not help increase investment but tended to undermine macroeconomic stability. In fact, the tighter monetary stance and the consequent increase in interest rates since the beginning of 2012 did not reduce the level of real investment in relation to GDP.¹¹ The shift in stance is also not quite consistent with the BB's commitment to avoid asset price bubbles and minimize excessive volatility of the exchange rate.

38. **Control of inflation should remain the BB's overriding objective.** Recent evidence from a few low-income African economies suggests that the shift to an inflation-targeting (IT) regime has contributed to relatively low inflation even where the preconditions for successful implementation of inflation targeting were not in place.¹² Often cited preconditions include full central bank independence, a well-developed technical infrastructure to forecast and model inflation, an economic structure under which domestic prices are not overly sensitive to commodity prices and exchange rates, and a healthy financial system. Overall, the evidence indicates that no inflation targeting economy had these preconditions fully in place before adopting inflation targeting. This suggests that failure to meet them is not by itself an impediment to shifting to IT. While Bangladesh may not be ready yet to make the shift, the key message that the control of inflation is, after all, the central bank's overriding medium-term objective is no less relevant to Bangladesh. The BB's own research convincingly demonstrates that the relationship between inflation and growth is non-linear.¹³ There exists a threshold level of inflation within the 7-8 percent range, implying that targeting too low an inflation level (i.e., relative to the threshold) may hurt growth; at the same time, too high a level may also impede growth. In this context, government's inflation target of 7.5 percent set in the 2012/13 budget appears reasonable as it falls within this range. Despite recent moderating trends in inflation, the restrictive monetary policy stance of the BB was in the right direction, since inflation is still running above the indicated threshold level.

Fiscal policy is on track to maintain prudent levels of the deficit and improve composition of deficit financing towards lower monetization and domestic bank financing, with higher concessional external financing. Revenue growth is likely to be below the budget target while ADP underutilization continues.

39. **The budget deficit (excluding grants) is likely to be below the target of 5 percent of GDP in fiscal 2013** (Figure 8). Government domestic borrowing has been restrained since the second half of fiscal 2012, underpinned by increased aid inflows and containment of fuel and electricity subsidies. Government borrowed nearly Tk 100 billion, or about 43.4 percent of total yearly target of Tk 230 billion from the banking sector and



¹¹ Mansur A. (2013), *Investment and Growth—Why Bangladesh Is Missing the Targets*, Policy Research Institute.

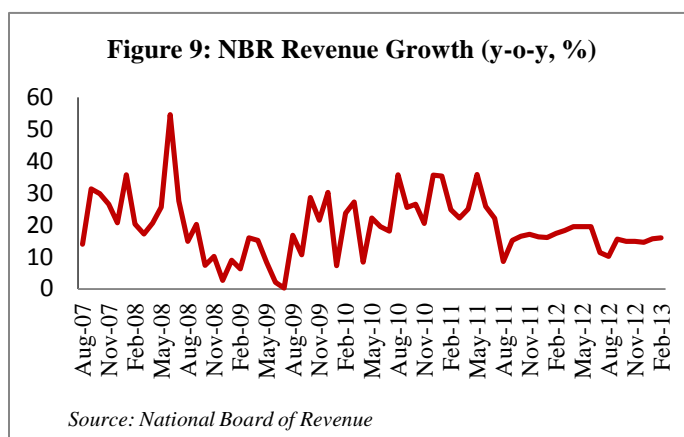
¹² Gemayel, Edward R.; Jahan, Sarwat; and Peter, Alexandra, *What Can Low-Income Countries Expect from Adopting Inflation Targeting?* IMF Working Paper, 2011.

¹³ Younus, Dr. Sayera, *Estimating growth-inflation tradeoff threshold in Bangladesh*, Bangladesh Bank, undated.

reduced its outstanding loans (at the beginning of fiscal 2013) from the BB by Tk 49.3 billion by mid-March, 2013. Foreign aid disbursement has exceeded expectations so far. Aid disbursements in the first half of fiscal 2013 was USD 1.3 billion compared to USD 0.9 billion in the same period last year.¹⁴

40. Revenue collection, particularly tax revenue, fell short of the July-February target for fiscal 2013.

The National Board of Revenue (NBR) collected about Tk 625.08 billion of its targeted Tk 656.21 billion in July-February of fiscal 2013. The Tk 31.14 billion shortfall was due mainly to lower customs duty, VAT, and supplementary duties collections relative to their targets. Overall growth of NBR tax revenue collection in the current fiscal year has been slower than last year: Revenue collection during July-February of fiscal 2013 grew by 16.1 percent vs. 17.5 percent in the same period last year (Figure 9). Trade-related taxes have increased by 8.8 percent compared to 11.3 percent in the same period in fiscal 2012. Collection from customs duty rose by 5.3 percent compared to 15.2 percent in the same period last year. Although, growth rate of VAT collections (from both import and domestic levels) is higher compared to the same period last year, overall growth in indirect taxes slowed to 12.7 percent in July-February of fiscal 2013, from 17.9 percent during the same period of fiscal 2012. Supplementary duty at both import and domestic levels increased by 5.9 percent and 2.8 percent respectively compared to last fiscal year, while income tax collection increased by 31 percent.



41. The revenue target is likely to be undershot this year. Although the NBR has had commendable success in mobilizing domestic resources in recent times, it may be difficult for it to attain the target set in the fiscal 2013 budget. In the past five years, the NBR comfortably surpassed its annual targets four times, failing only in fiscal 2009 when Bangladesh's economy suffered the lagged impact of the global economic crises. Revenue growth this year has suffered in the backdraft of lower collection from import duties due to falling global commodity prices and slowdown in economic activities. Collection of income tax may face a setback in the coming months. Banking, traditionally the largest income tax paying sector, faces a decline in profit. In fact, seven large commercial banks experienced net losses in the first quarter of fiscal 2013. Banks' inability to recoup the loans of some borrowers has harmed their profitability prospects. This is also evident from the rising "doubtful" and "classified" loans in recent quarters. The slowdown in (import) trading business arising out of some of the recently enforced restrictive policies (towards controlling import payments) has also resulted in relatively low profit performance of the banking sector.

42. The NBR is taking measures to boost tax revenue collection in the remaining months of fiscal 2013, particularly by identifying new potential VAT sectors and widening the income tax net. The field offices have already started to scan tax files of those who are still out of the tax net. The NBR has instructed nearly 1,200 large corporate taxpayers to install the NBR-prescribed software from January 1 2013 with a view to maintaining transparency in the accounting system. As large corporate taxpayers are using their customized software, which was not approved by the NBR, non-recorded transactions in businesses create a roadblock to VAT collection.¹⁵ Non-tax revenue collection has spiked up. Non-tax revenue collection, which accounts for about 16.4 percent of total revenue, rose by 72.6 percent in July-

¹⁴ US\$1.3 billion aid received in first half of fiscal 2013, The Financial Express, 22 January, 2013

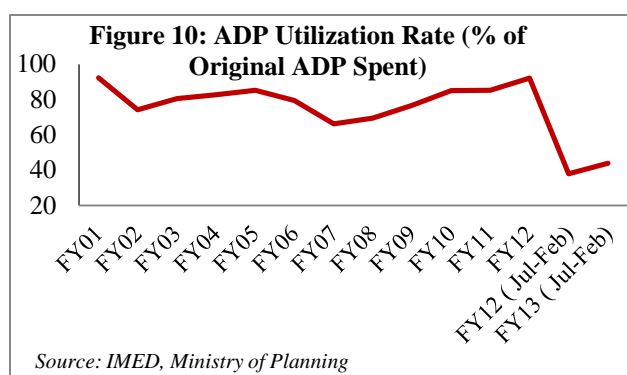
¹⁵ NBR-prescribed software made mandatory from today, The Financial Express, 1 January, 2013

November of fiscal 2013. The outstanding growth performance of non-tax revenue was primarily due to Tk 46.6 billion received from Bangladesh Telecommunication and Regulatory Commission (BTRC).¹⁶

43. **Government's expenditure is on track, despite overshooting of current expenditure due to a surge in interest payments on earlier borrowing from domestic sources.** During July-November of fiscal 2013, total non-development spending was 33.7 percent of the budget estimates, compared with 30.7 percent in the same period last year. The shares of non-development expenditure show that, during July-November of fiscal 2013, spending on subsidies and current transfers was Tk 147.6 billion, followed by spending on pay and allowances of Tk 98.3 billion, and interest payments of Tk 91.2 billion. Up to November, the largest individual sector share in non-development spending was interest payments (24 percent).¹⁷

44. **ADP utilization has improved (Figure 10).**

During FY13 (July-February), 44 percent of total ADP allocation was spent compared to 38 percent in the corresponding period of the previous year. Closer engagement with spending ministries and development partners has led to this modest improvement in implementation. Among ministries and divisions with the top 10 largest allocations, the Power and Roads utilized 61 and 60 percent of their respective allocations, followed by 57 percent utilization by the Local Government Division and 54 percent utilization by the Ministry of Primary and Mass Education. The Ministry of Education utilized 52 percent. The utilization rates for the remaining five—Energy and Mineral Resources, the Ministry of Water Resources, the Ministry of Health and Family Welfare, the Ministry of Railways and the Ministry of Industries were at 45 percent, 37 percent, 34 percent, and 22 percent respectively.



45. **The government is committed to pursuing a moderate fiscal consolidation path** by increasing revenue and containing subsidies to expand space for investment spending, while keeping fiscal risks in check. The overall fiscal stance has remained prudent, but under-achieving tax revenues and stubbornly large subsidies need close surveillance. More aggressive tax enforcement can raise collections in the short-term while the new VAT law implementation, coupled with income tax reforms, could transform the tax regime in the medium term. Better cost management and price adjustments will be needed to contain subsidies, along with better targeting in safety net programs to protect the most vulnerable. Keeping fiscal risks in check will require focused attention on concessional financing complemented with selective use of non-concessional borrowing to keep total debt levels manageable. The latest Debt Sustainability Analysis updates reconfirm that with the borrowing path currently envisaged in the Medium-Term Budget Framework, Bangladesh would remain at low risk of debt distress. This space should be used mainly to bridge Bangladesh's large infrastructure and energy deficits that have become the most binding constraints on private investment, growth and poverty reduction.

Slow and mixed progress on structural reforms

46. **The IMF board completed its first review of Bangladesh's 3-year economic program, and approved disbursement of the second US\$139.4 million ECF tranche in February.** This brings the

¹⁶ Centre for Policy Dialogue (CPD), "Analytical Review of Bangladesh's Macroeconomic Performance in Fiscal Year 2013" January 2013.

¹⁷ Information collected from Monthly Report on Fiscal Position, Ministry of Finance, October, fiscal 2013.

total amount disbursed equivalent to SDR 182.8 million (about US\$ 278.8 million) out of SDR 640.0 million (about US\$ 975.9 million). The main objectives of the government's ECF-supported reform program includes restoring macroeconomic stability, strengthening the external position, and engendering higher, more inclusive growth. The program targets in 2013 are anchored by continued fiscal and monetary restraint, building on initial stabilization gains and locking in reserves outperformance. Structural measures aim to modernize the tax regime, bolster fiscal controls, strengthen financial sector oversight, and improve the trade and investment climate in order to reduce vulnerabilities and achieve development priorities, as laid out in Bangladesh's Sixth Five-Year Plan. Policy undertakings have been broadly in keeping with program commitments under the ECF. All performance criteria were met by the end-June 2012 (first) test date and indicative targets for end-June and end-September 2012 were also largely on track. While preliminary indicators for select quantitative targets show that they, too, were met at the end-December 2012, the continuous performance criterion on new non-concessional external debt maturing in more than one year was not observed because of new borrowing in January 2013. Likewise a number of structural benchmarks were not met, either due to delays in completion or the need for more time to make legislative changes or reach internal policy consensus.

47. **The parliament passed the new Value Added Tax Law in November.** The law is intended to increase revenue and promote compliance by broadening the tax base and modernizing the tax regime. It establishes a single VAT rate of 15 percent at all levels and broadens the VAT base by reducing the list of commodities currently exempt from VAT. Under the new law, all economic sectors (imports, manufacturing, and services) will be brought within the scope of VAT, with tax paid on the basis of *actual transactions values* instead of highly compressed and arbitrarily *negotiated approved values* embedded in the rate schedules (for manufactures) and on truncated bases (for imports and services) under the existing law. To help reduce the tax burden and compliance cost faced by individual taxpayers, the new law has removed some features such as the requirements for taxpayers to receive price approvals from tax officers and deposit VAT in the government treasury in advance of making supplies. It also significantly strengthens NBR's power by giving it the authority to freeze a tax debtor's bank accounts, impose a lien on the property of a tax debtor, and recover tax arrears from company directors. A VAT Steering Committee has been appointed to finalize cost estimates for implementation of the law and securing funding commitments. The IMF has estimated that once the new VAT law is fully implemented, it could increase the tax collections by nearly 2 percent of GDP.

48. **Bangladesh Bank gave final approval to seven new banks** out of the nine that were initially proposed. The BB scrutinized the business plans of these banks before providing final clearance. Out of the seven banks, two are sponsored by non-resident Bangladeshis. One particular bank initially listed the current Home Minister as chairman of the board. However, the minister relinquished this position in order to avoid any conflict of interest. The banks will now be registered with the Office of the Registrar of Joint Stock Companies and Firms to set up banking companies. The BB will then license the names of the banks. Experts fear that the entry of these new banks into an already-saturated market might create distortions new regulatory issues. The remaining two proposed new banks are in the process of submitting their business plans in hopes of final approval.

49. **Two new price indices were introduced by the Dhaka Stock Exchange (DSE) to reflect the stock market movements more accurately.** The indices, DSEX and DS30, were developed by Standard and Poor's (S&P) based on free-float methodology.¹⁸ The DSEX, also known as the broad index, will be the benchmark general index, reflecting around 97 percent of the total market capitalization and is

¹⁸ Market capitalization under free-float methodology is calculated by equity's price and multiplying it by the number of shares readily available in the market. Free-float methodology has been adopted by most of the world's major indices, including the Dow Jones Industrial Average and the S&P 500.

composed of 199 companies. The base value of the DSEX was set at 2951.91 points, the value of the previous DSE General Index (DGEN) at the time. However, the DSE is currently continuing both the DSEX and DGEN to reflect market activities. The DS30 index will replace the previous DS20 as the investable index of DSE, and consists of the top 30 companies based on profitability, market capitalization, liquidity and financial viability. It reflects around 51 percent of market capitalization. The DS30 will be rebalanced bi-annually based on the half-yearly trading performance of the companies, while the DSEX will be rebalanced yearly on the basis of year-end closing.

50. **The auction to sell third generation (3G) licenses to the telecom operators will be conducted in fiscal 2013.** The government has finalized the guideline for 3G licenses and the auction is scheduled to be conducted on June 24, 2014. The base price of the licenses has been set at US\$20 million per MHz spectrum. Four licenses will be awarded in the auction. However, a dispute between the government and the telecom operators about paying VAT under 2G licenses has yet to be resolved.

51. **The government approved a new export policy for 2012-15.** With the expiry of the last export policy on June 30, 2012, the government introduced a new policy for the next three years. Under this policy, the government has expanded the number of thrust sectors to ten, including terry towel and tourism. A ban on exports of rice, sugar and edible oil (soybean and palm) has been imposed for the three years. The value of samples allowed to be sent by pharmaceutical companies to overseas buyers has been doubled to US\$ 60,000 per year. To help make information more readily available to different stakeholders, the policy intends to set up a national data bank containing detailed information on import, export, tariffs, etc. in cooperation with non-governmental organizations. The policy also suggests establishing joint testing labs to ensure necessary standards for exportable products. The policy was formulated in consultation with trade bodies, associations, and other stakeholders.

52. **Administered fuel prices increased by an average 8.4 percent.** In January 2013, the prices of kerosene and diesel were raised by Tk 7 per liter, and petrol and octane by Tk 5 per liter. The increases should decrease the fuel subsidy by Tk 25 billion (around US\$300 million). However, the subsidy reduction was partially offset by the decision to increase the commission rates on retail sales of fuels. The commission rates on diesel, octane, petrol and kerosene increased by Tk 0.25, Tk 0.51, Tk 0.49, and Tk 0.20 per liter respectively. This represents a 20 percent average rise on the commission rates. The adjustment in fuel prices brought an immediate increase in the official bus fare by Tk 0.10 per kilometer for intercity travel.

53. **The government has nationalized 26,192 primary schools.** This brought about 126,000 primary teachers onto the public payroll, which is expected to cost the government an extra Tk 1 billion (US\$12.6 million) in fiscal 2013, Tk 1.7 billion (US\$21.6 million) in fiscal 2014 and Tk 2.8 billion (US\$35.3 million) in fiscal 2015.¹⁹ The government also decided to increase house rents and medical allowances for non-government education institutions enjoying monthly pay order (MPO) facilities, which will result in an additional expenditure of Tk 2.4 billion (US\$30.3 million).²⁰ The additional fiscal costs will be accommodated within the budget by utilization provisions from block allocations.

54. **The Bangladesh Bureau of Statistics is rebasing the GDP from fiscal 1996 to fiscal 2006.** Having rebased the inflation calculation to fiscal 2006 this fiscal year, the BBS is also rebasing GDP calculations to fiscal 2006, starting with the fiscal 2013 estimates. The BBS has already conducted a survey of four new service sectors—decoration, security services, recruiting services, and cleaning services and estimated a 0.52 percent increase in GDP in nominal terms if these services were accounted for. The BBS has also included 163 more products in the industrial output basket to calculate their

¹⁹ Source: Finance Division.

²⁰ House rent, medical allowances hiked, The Daily Star, January 23, 2013.

contribution to GDP. The GDP calculations under the new base may significantly increase the country's GDP and per capita GDP estimates.

Development Progress

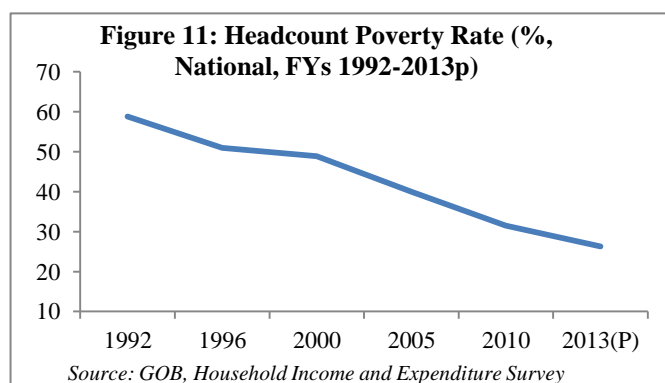
The pace of poverty reduction in Bangladesh accelerated in the decade 2001-2010 compared to 1991-2000. The country has also made good progress with its Millennium Development Goals (MDGs).

Bending the arc of poverty reduction

55. At the World Bank's 2012 annual meetings, Bank Group President Jim Yong Kim called for global solidarity to "bend the arc of history",²¹ and for a relentless drive for results to "build shared prosperity and end poverty".²² Bangladesh, which is home to about 5 percent of the world's poor population living on less than US\$1.25 per day, will be a key battleground in the international fight against poverty.

56. **Bangladesh achieved good progress in poverty reduction over the past decade.**

The pace of poverty reduction in Bangladesh increased significantly during 2001-2010 compared with the previous decade (Figure 11). The number of poor declined by 15 million compared with 2.3 million in the earlier decade. Bangladesh's poverty headcount rate fell by about 1.75 percentage points per year during the later period—though not quite as rapidly as the remarkable 2.5 percentage points per year decline that China experienced during this period, Bangladesh's rate of poverty reduction was nevertheless almost twice as fast as that experienced by the rest of the world: between 1999 and 2008, the poverty headcount rate in India and the rest of the developing world, excluding China, declined by an estimated 0.9 percentage points per year.



57. **Growth of labor income and lower dependency ratio were the main drivers of poverty reduction.** During the first part of the 2001-2010 decade, the increase in wages in the non-farm sector was the most important factor contributing to poverty reduction. At the same time, three key "poverty reducing" shifts also took place: (1) workers moved away from agriculture towards manufacturing and services; (2) many workers gave up daily and self-employed work for salaried jobs; and (3) the average level of education of the workforce increased. During the second half of the decade most of the poverty reduction occurred in the farm sector, in particular through a significant rise in labor income, which interestingly was not associated with higher education or with changes in occupation. The rise in labor incomes was accompanied by a decline in the earnings' penalty associated with living outside of Dhaka, which also contributed to reducing poverty. Apart from increase in labor income, changes in the demographic composition of the population, in particular lower dependency ratios due to an increase in the adult population and a decline in the fertility rate, also helped reduce poverty over this period.

²¹ *Bangladesh Poverty Assessment 2010: Assessing a decade of progress in reducing poverty* (forthcoming), World Bank, Washington DC.

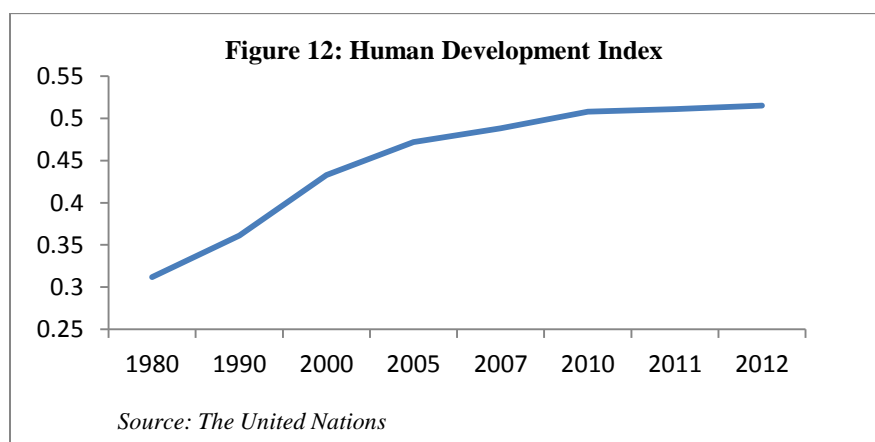
²² Remarks as prepared for delivery at the annual meeting plenary session in Tokyo, Japan, October 11, 2012.

58. **Several non-consumption-based welfare measures also improved significantly.** During the 2000-2005 period, all households saw large improvements in the quality of their homes. For example, a large number of households reported improvements in the quality of the materials used in construction of houses as well as in their access to services such as sanitary latrines and electricity. Between 2005 and 2010, while the poor continued to report improvements in the quality of their homes in the above-mentioned dimensions, the largest improvements for all households were in ownership of consumer durables and amenities, such as television sets and access to cellular phones.

Shared prosperity

59. **Available data suggest that income inequality in Bangladesh has stabilized.** Both the Household Income and Expenditure Survey (HIES) and national accounts data indicate that, unlike the 1991-2000 period, growth in Bangladesh over the last decade was characterized by two positive trends: a high rate of poverty reduction and a stabilized level of inequality relative to other countries in the region. However, notwithstanding these observed improvements, Bangladesh continues to have the highest rate of poverty relative to its South Asian counterparts. Bangladesh's five-year cumulative rate of GDP growth for the 2005-2010 period was below the South Asian average growth rate—a rate primarily driven by India's high growth pace. By the end of the decade, Bangladesh's per-capita GDP (in constant 2000 US\$) was the lowest in the region, with the exception of Nepal. This relatively low real per-capita GDP growth explains why Bangladesh also continues to have the highest rate of poverty in the region.

60. **Some convergence in regional poverty rates occurred in the second half of the 2000-2010 decade.** The poverty headcount figures of the first half of the decade revealed that while poverty decreased in both rural and urban areas, the reduction was highly uneven, favoring the eastern part of the country over the west. The same figures for the latter part of the decade indicate that these east-west poverty differences have diminished significantly. The analysis suggests that the observed convergence in poverty indicators resulted from the positive impact of increases in prices of agricultural goods on those employed in the agricultural sector. Moreover, the poverty-reducing demographic changes taking place in the second half of the decade were larger in the west relative to the east. These patterns suggest that higher returns to demographic changes over this period may have allowed the west to catch up with the east.



61. **Human development is an emerging pillar of strength in Bangladesh** (Figure 12). Even though Bangladesh's HDI value for 2012 puts it in the low human development category, positioning the country at 146 out of 187 countries, this is an area where visible improvements are happening.

- Between 1980 and 2012, Bangladesh's HDI value increased by 65 percent, an average annual increase of about 1.6 percent. Bangladesh was among the 18 “highlighted” countries of the South “that had greater gains on the HDI between 1990 and 2012 than would have been predicted from their previous performance on the HDI.”²³
- Bangladesh's 2012 HDI of 0.515 is above the average of 0.466 for countries in the low human development group, but below the average of 0.558 for countries in South Asia.

62. **Human development has been relatively inclusive in Bangladesh**

- When the value of Bangladesh's HDI of 0.515 is discounted for inequality, the HDI falls to 0.374, a loss of 27.4 percent due to inequality in the distribution of the component sub-indices (life expectancy, education, and income). This moves Bangladesh's ranking up by five places, indicative of greater equality.
- Bangladesh has done relatively well in ensuring gender parity in economic opportunities. It has a Gender Inequality Index value of 0.518, ranking it 111 out of 146 countries in the 2012 index. Within South Asia, Bangladesh appears to be doing a lot better than most other countries in terms of gender parity in education.

63. **Most of the gains in human development in Bangladesh have taken place since the early 1990s.** Progress in social development indicators has outpaced growth in per-capita GDP. Consequently, while three decades ago Bangladesh was lagging behind countries with similar per-capita income levels, it is now an over-performer in most social development indicators relative to its per-capita GDP.

64. **Further depth and breadth are needed in development progress.** Access to professional health care in Bangladesh remains low. Even in the face of outstanding achievements in reducing poverty and childhood underweight at the national level, achieving all of the hunger MDGs remains a challenge. Bangladesh faces a tough road in addressing certain pockets of poverty that lag far behind national averages (urban slums, the hill tracts, coastal belts, and other ecologically vulnerable areas). School drop-out rates remain high. Enrolling the last 10 percent of hard-to-reach children in schools, ensuring quality education, and promoting gender equity in tertiary education remain major challenges. The threat of climate change could also diminish hard-earned benefits of years of growth and development, not just for people in impoverished settlements along coastal belts and river banks, but across the entire nation.

65. **A governance deficit is the Achilles heel of Bangladesh's development progress.** Good governance, a critical dimension of development, has been formally absent from the MDG framework. Progress towards the MDGs depends crucially on a country's policy and institutional framework. A growing body of empirical evidence suggests a good policy framework results in greater progress on hunger and maternal mortality, gender parity in education, child mortality, and access to safe water.²⁴ The link is stronger for MDGs with institutional dimensions. For instance, it is necessary to have functioning health systems for child and maternal mortality to decline.

66. **Over the past 15 years, researchers have increasingly focused on the link between poor governance, corruption, and development progress.** The cross-country evidence has shown how poor governance and corruption can be harmful for the standard of living and the distribution of income of citizens, reducing income per capita, literacy, while increasing infant mortality. Further, poor governance distorts public expenditure and increases poverty, reducing investment efficiency. However, the

²³ UNDP, Human Development Report 2013, p. 12.

²⁴ *MDGs and Beyond*, World Bank, February, 2013.

relationship between more disaggregated measures of governance and attainment of MDGs shows a more mixed and partially counter-intuitive picture. Control of corruption is negatively associated with reducing hunger, but positively related to achieving gender parity in education; and even political stability appears negatively associated with two goals, child and maternal mortality, while positively correlated with reduced income poverty and hunger. Thus, the role of governance is complex and causality runs both ways. Good institutions contribute to development, while a more educated and healthier population in a vibrant economy is more likely to demand better governance. In the quest to better understand the interactions between changes in governance and development results, the issues of accurately measuring both levels and improvements in good governance looms large.

Progress on MDGs

67. **Bangladesh has performed impressively in pulling people out of poverty, ensuring that more girls and boys attend school, and have access to clean water.** Considerable progress has been made in the child survival rate. There have been some improvements to address the country's massive environmental challenges over the past decade as well. Of the 28 MDG targets, Bangladesh has already achieved 3 and is on track with 11, but still needs to give attention to the remaining 14 (as of 2011—Table 1).

68. **Bangladesh is on track to reach the poverty and depth of poverty MDGs for 2015.** At the national level, poverty depth was nearly halved over the 2000-2010 period, allowing Bangladesh to achieve the MDG target of halving the depth of poverty from 16 percent to 8 percent at least five years earlier than expected. The projections for the prevalence of poverty based on the last three HIES surveys suggest that Bangladesh will achieve the MDG goal of halving the poverty headcount (i.e., the proportion of the population below the upper, national poverty line) to 28.5 percent sometime before the end of 2013.

69. **Progress has been commendable in several other MDGs.** The maternal mortality ratio of Bangladesh, at 194, has shown a major turnaround. Bangladesh has seen a 40 percent decline in maternal mortality from 2001-2010; so is on track at a 'national' level to achieve MDG5 Target A—reduce maternal mortality. Performance on this goal, which was lagging, is a major achievement that has received UN recognition. During 2005-2010 Bangladesh witnessed significant improvements in access to health care, the most notable achievement being the significant decline in the immunization gap between the poor and the non-poor. Bangladesh is also on track to achieve the net enrolment target. Nutrition outcomes have been poor.

Table 1: Bangladesh—Millennium Development Goals Progress

Millennium Development Goals		Base Year FY1991	Target by 2015	Current Status
Goal 1:	Eradicate Extreme Poverty and Hunger			
	Percentage of population below national poverty line	56.6	29	31.5 (HIES 2010)
	Poverty Gap Ratio (percent)	17	8	6.5 (HIES 2010)
	Percentage of population below minimum dietary energy consumption	28	14	16.8 (WDI 2011)
Goal 2:	Achieve Universal Primary Education			
	Net enrollment in primary education (percent)	60.5	100	94.9 (BANBEIS 2010)
	Percentage of pupils starting grade 1 reaching grade 5	40.7	100	67.2 (DPE 2010)
Goal 3:	Promote Gender Equality and Empower Women			
	Ratio of girls to boys in primary education	0.83	1	1.02 (BANBEIS 2010)
	Ratio of girls to boys in secondary education	0.52	1	1.14 (BANBEIS 2010)
	Ratio of girls to boys in tertiary education	0.37	1	0.39 (BANBEIS 2010)
	Share of women (percent) in wage employment in the non-agricultural sector	19.1	50	19.87 (LFS 2010)
	Proportion of seats (percent) held by women in Parliament	12.7	33	19.7 (WDI 2012)
Goal 4:	Reduce Child Mortality			
	Under-five mortality rate (per 1,000 live births)	146	48	46 (WDI 2011)
	Infant mortality rate (per 1,000 live births)	92	31	36.7 (WDI 2011)
	Percent of 1 year-old children immunized against measles	54	100	85.3 (UESD 2010)
Goal 5:	Improve Maternal Health			
	Maternal Mortality Ratio (per 100,000 live births)	574 (1990)	144	194 (BMMS 2010)
	Percentage of births attended by skilled health personnel	5	50	26.5 (BMMS)
Goal 6:	Combat HIV/AIDS, malaria, and other diseases			
	Prevalence of Malaria per 100,000 population	776.9 (2008)	310.8	512.6 (MIS DGHS 2010)
	Death rate associated with Malaria per 100,000 population	1.4 (2008)	0.6	0.32 (MIS DGHS 2010)
	Prevalence of Tuberculosis per 100,000 population	639	320	79.4 (NTPS 2010)
	Cure rate of Tuberculosis under DOTS (percent)	73 (1994)	>85	92 (MIS DGHS 2010)
Goal 7:	Ensure Environmental Sustainability			
	Proportion of land area covered by forests (percent)	9	20	19.33 (DOF 2011)
	Percent of population using an improved drinking water source	78	-	81 (WDI 2010)
	Percent of population using an improved sanitation facility	39	-	56 (WDI 2010)
Goal 8:	Develop a Global Partnership for Development			
	Net ODA received by Bangladesh (USD million)	1,240	-	1245 (BB 2012)
	Debt service as percentage of export of goods and services	20.9	-	4.9 (BB 2012)

BB - Bangladesh Bank; BANBEIS - Bangladesh Bureau of Educational Information and Statistics; BMMS Bangladesh Maternal Mortality Survey; DPE - Department of Primary Education; DOF - Department of Forest; HIES- Household Income and Expenditure Survey; LFS- Labor Force Survey; MIS DGHS - Management Information System Directorate General of Health Services; NTPS - National Tuberculosis Control Program; UESD - Utilization of Essential Service Delivery; WDI- World Development Indicator.

Short- to Medium-Term Development Opportunities

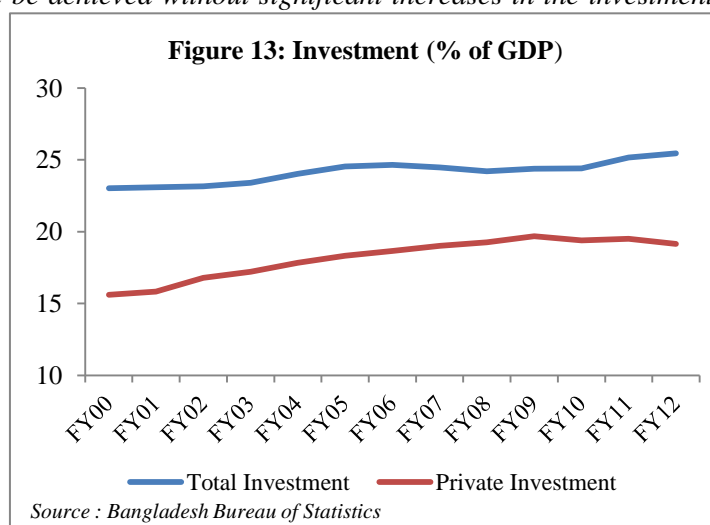
70. **Bangladesh has a historic—but time-bound—opportunity to reach 8 percent growth.** Over the next ten years, Bangladesh has the potential to grow at more than 8 percent annually. During 2000-2010, labor productivity grew at 2.6 percent per annum, labor force participation grew at 2.1 percent, and population grew by 1.4 percent, while the employment rate stagnated. Consequently, average GDP growth rate has been about 6.1 percent. Boosting employment growth to about 2 percent per annum (slightly over a million jobs per year), while maintaining trend labor productivity growth, will take GDP growth to over 8 percent, and will put Bangladesh on the path of realizing its vision of becoming a middle-income country by 2021. Bangladesh is poised to exploit the long-awaited “demographic dividend” with a rising share of working age population. Its growing and abundant labor force is currently highly underutilized. On the other hand, Bangladesh’s competitors are becoming expensive places in which to do business.

71. **International investors are looking for low-cost manufacturing in Bangladesh.** China’s exports of labor-intensive manufactures is projected to decline in the near- and medium-term, as rising wages reduce the country’s competitiveness in labor intensive production. Bangladesh is much more competitive on labor costs compared to India, Indonesia, Vietnam and Cambodia.²⁵ Taking advantage of this low cost edge over its competitors, Bangladesh could become “the next China” if it can break the infrastructure, energy, and land bottlenecks and more properly utilize its large pool of under-employed labor. Global buyers in garments confirm this assessment by placing Bangladesh on top of their shopping list (McKinsey). Goldman Sachs has included Bangladesh as one of its “Next-11” countries characterized by rapidly growing populations combined with significant industrial capacity or potential. East Asia is more expensive, Pakistan too risky, India too regulated, and Africa—which also has a competitive labor force (e.g., Ethiopia)—does not yet have the production capacity and track record to be a major competitor.

Breaking out of the low investment trap is the biggest immediate challenge

In seizing these opportunities, the most critical challenge for Bangladesh will be to raise the investment rate by at least 5 percentage points of GDP, a precondition for accelerating growth by 1.5-2.0 percentage points. Sustained increases in growth cannot be achieved without significant increases in the investment rate in the private sector. Despite a liberal investment regime, the rate of private investment has remained low relative to Bangladesh’s peer group of countries.

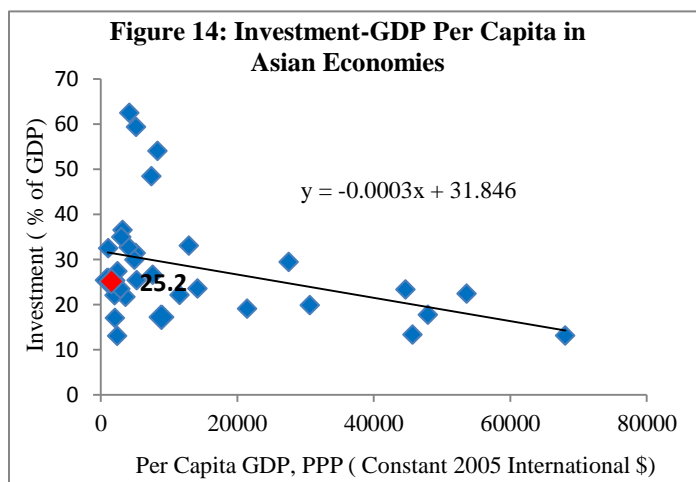
72. **Investment has stagnated at a relatively low level in recent years** (Figure 13). The experience of successful developing countries in Asia in recent decades clearly shows that the historically high economic growth recorded by these economies is essentially the result of increased levels of investment in relation to GDP. Capital deepening primarily drives the acceleration of growth in low-income



²⁵ Bangladesh: Towards Accelerated, Inclusive and Sustainable Growth, Opportunities and Challenges, June, 2012, World Bank, Washington DC.

economies. Other efficiency gains, including the contribution of labor through productivity gains generally tends to take root at a more advanced stage of development or capital deepening process. Lack of improvement in general economic, political and governance indicators have contributed to stagnation in private investment in relation to GDP.

73. A regression of the investment rate on per capita GDP of 33 Asian economies suggests investment in Bangladesh should have been 31.4 percent of GDP in fiscal 2011 based on its per capita GDP, whereas the actual investment rate that year was only 25.2 percent. Thus, Bangladesh has been under-investing to the extent of 6.2 percentage points of GDP (Figure 14). The rate of foreign direct investment (FDI), in particular, has been low in relation to its recent growth track record: Bangladesh received US\$995 million in FDI in fiscal 2012—a paltry amount compared to the US\$39 billion in foreign investment that the entire South Asia region attracted in 2011.²⁶



74. **Bangladesh is well positioned to attract increased investment by expanding its success in ready-made garment exports to other sectors, especially those that are labor-intensive.** Bangladesh's economic outlook always comes out very strongly in all economic assessments by credit rating agencies (which are mostly conservative) or by Goldman Sachs, McKinsey, The Financial Times, and The Wall Street Journal. This should attract the attention of frontier market investors. Bangladesh's investment regime is investor-friendly, and ranks favorably in protection of investors. The government actively seeks foreign investment, particularly in energy and infrastructure sectors. It offers a range of investment incentives under its industrial policy and export-oriented growth strategy, with few formal distinctions between foreign and domestic private investors. Legislation offers incentives for investors, including: 100 percent foreign ownership in most sectors; tax holidays; reduced import duties on capital machinery and spare parts; duty-free imports for 100 percent of exporters of ready-made garments; and tax exemptions.²⁷ Customs bonded warehouses enable companies located in export processing zones (EPZ) to avoid duty payments on inputs for goods that will be exported. There are few performance requirements, and these do not generally impede investment.

75. **Several special economic zones have been set up across the country.** Under the Bangladesh Export Processing Zones Authority Act of 1980, the government established an EPZ in Chittagong in 1983. Additional EPZs now operate in Dhaka (Savar), Mongla, Ishwardi, Comilla, and Uttara. In addition, two new EPZs are being established in Karnaphuli (Chittagong) and Adamjee (Dhaka). Korean investors are developing a private EPZ in Chittagong. Investments that are 100 percent foreign-owned, joint ventures and 100 percent Bangladeshi-owned companies are all permitted to operate and enjoy equal

²⁶ It is generally believed that 1-2 percent of GDP in additional FDI would help increase GDP growth by 0.5-1.0 percent on average. The employment generation effect of such investment would be significant, in the range of 150,000-300,000 per year in the formal sector. The economic impetus created by the additional FDI inflow would help the balance of payments without creating external debt (see Mansur A., *ibid*).

²⁷ Key laws in Bangladesh aimed at promoting foreign investment include: the Foreign Private Investment (Promotion and Protection) Act of 1980; the Industrial Policy Act of 2005; the Bangladesh Export Processing Zones Authority Act of 1980; the Companies Act of 1994; and the Telecommunications Act of 2001.

treatment in the EPZs. Approximately a dozen U.S. firms—mostly textile producers—are currently operating in Bangladesh EPZs. In 2010, Bangladesh enacted a Special Economic Zone law that allows the creation of privately-owned Special Economic Zones (SEZs) that can produce for export and domestic markets. The government has established a Bangladesh Economic Zone Authority (BEZA), modeled after the export processing authority, to implement the new law and oversee the establishment of SEZs. The existing zones, with their limited scope, scale, and ambition, have not produced the desired results. In other countries' reform experiences, poorly performing zones have been able to transform themselves by liberalizing their policy regimes and aggressively pursuing private sector participation.

76. **Where is Bangladesh failing?** Despite all of the favorable conditions, Bangladesh has failed to become an attractive destination for FDI. Even Sri Lanka, which was going through a devastating civil war, had much better performance in FDI flows. Domestic private investment has also stagnated. Analytical work and policy dialogue over the years have produced the following consensus on key binding constraints to investment in Bangladesh:

- *Limited access to serviced land:* Cost of land, complications in the acquisition of land and unavailability of serviced land.
- *Power and gas shortages:* Shortfalls in production capacity, transmission and distribution.
- *Labor market rigidity and gender segregation:* Difficulties in hiring, firing, and training and structural constraints to gender equity.
- *Red tape:* A cumbersome bureaucracy and the difficulty in enforcing contracts.

Opportunities for Inclusion

Labor markets are the main channels through which economic growth is distributed to people. Employment of a family member is the biggest safety net for families in Bangladesh because of the absence of unemployment and pension benefits.

77. **Employment is the primary source of income for most households in Bangladesh.** This is especially true for poor households whose only abundant productive resource is their own labor. Increasing employment opportunities and raising the returns to labor is therefore the most direct way of meeting the livelihood requirements. However, simply having access to employment is not enough to lift poor households out of poverty. The government's development strategy recognizes the need to orient growth policies toward creating productive employment opportunities. It emphasizes several options, such as adopting policies for making growth more employment-friendly, increasing overseas migration of workers, and undertaking special employment-creation programs through micro credit, employment-based safety nets and public works programs.²⁸

78. **The central long-term question is where will Bangladesh's good jobs come from?** Productive jobs are vital for growth. And a good job is the best form of inclusion. More than half of Bangladesh's population depends on agriculture, but the experience of other countries suggests that the number of people dependent on agriculture will have to shrink if per-capita incomes in agriculture are to rise substantially. While industry is creating jobs, too many are low-productivity non-contractual jobs in the unorganized sector, offering low incomes, little protection, and no benefits. Services jobs are relatively high productivity, but employment growth in services has been slow in recent years. Bangladesh's challenge is to create the conditions for faster growth of productive jobs outside of agriculture, especially in organized manufacturing and in services, even while improving productivity in agriculture. The benefit of rising to the challenge is decades of strong, inclusive growth.

²⁸ Bangladesh Sixth Five-Year Plan, GoB, March 2011.

79. **Domestic employment generation in the medium term is likely at best to be barely enough to absorb new entrants in the domestic labor market.** At current employment elasticity of growth (0.4) and under the baseline growth scenario, Bangladesh can expect to generate about 1.3 to 1.6 million jobs per year (Table 1). Its domestic labor force is projected to grow by 1.3 million per year. This will hardly make a dent in the stock of unemployed until growth picks up to 6.5 percent-plus after fiscal 2014. Even that will not be enough to bring the unemployment rate down to single digits. Job creation on a significant scale would require a lot more than business as usual.

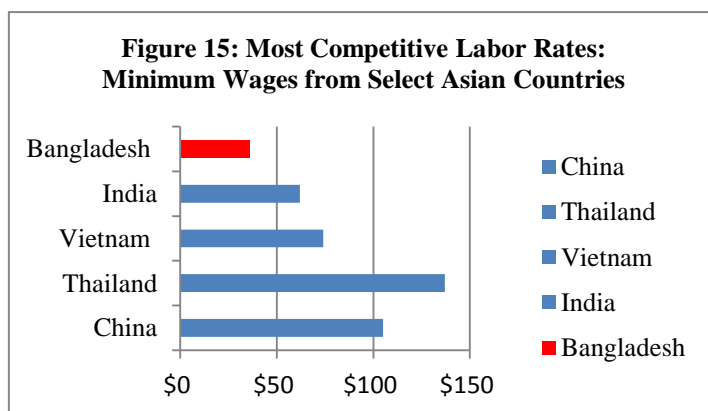
Table 2: Bangladesh : Labor market Projections

	2010	Projections						
		2011	2012	2013	2014	2015	2016	2017
Real GDP growth (%)	6.10	6.70	6.30	5.80	6.20	6.50	6.70	6.90
Labor force (millions)	56.65	57.95	59.22	60.53	61.86	63.22	64.48	65.77
Change in labor force (millions)	-	1.30	1.27	1.30	1.33	1.36	1.26	1.29
Percentage change in employment	2.44	2.68	2.52	2.32	2.48	2.60	2.68	2.76
Employment (millions)	48.63	49.94	51.20	52.39	53.68	55.08	56.56	58.14
Change in employment (millions)	-	1.31	1.26	1.19	1.30	1.40	1.48	1.58
Unemployment (in millions)	8.03	8.01	8.02	8.14	8.17	8.14	7.93	7.63
Unemployment rate (%)	14.17	13.82	13.55	13.45	13.21	12.87	12.29	11.60

Note: Total unemployed persons by economic category is a combination of unemployed population aged 15 years and over and unemployment equivalent of underemployed & unpaid family workers working less than 15 hours/week. Source: Calculated from Labor Force Survey, Bangladesh Bureau of Statistics, IMF.

A strategy for creating 15 million jobs in 10 years

80. **Bangladesh has the potential to capture at least 15 million jobs in the next ten years.** Recent reports (e.g., McKinsey/USAID) have shown that the productivity of Bangladeshi workers is on par with Chinese workers in well-managed firms with their wages being five times lower than those of their Chinese counterparts (half those in Vietnam). Bangladesh's unique competitive position comes at a time when China is in the process of outsourcing 80 million jobs from labor-intensive industries (Figure 15).



81. **There are tangible actions Bangladesh needs to take to attract domestic and foreign investments for productive job creation.** Bangladesh's ability to attract investment and create jobs has been hampered by:

- Lack of space in well-located industrial zones;

- Expensive financing, especially trade finance;
- Insufficient power and transport infrastructure, and;
- Limited promotion of the country's advantages

The following four actions by the government will begin to tackle these constraints and open the possibility for Bangladesh to seize its historic opportunity of creating 15 million jobs over the next decade:

- **Bangladesh Economic Zones Authority (BEZA) to enable 40,000 acres for economic zones.** Economic zones will provide the private sector with easy access to land and an improved infrastructure and streamlined administrative procedures. Calculations based on Bangladesh's EPZs and those of other countries, indicate that 40,000 acres of land will be needed to create 15 million jobs. Some of this land could come from rejuvenating idle state-owned enterprises (following the successful model of the Adamjee Jute Mills) and moribund tea estates.
- **PPP Office to manage the tendering for needed infrastructure.** The PPP Office will have a critical role in managing the PPP tenders for key infrastructure such as power and transport that the zones will need to operate. An additional 5,000 MW of electricity will be needed for the creation of 15 million jobs. This does not need to be a drain on public finances as the private sector would be eager to pay the full market price for quality power and transport infrastructure.
- **Bangladesh Bank to put in place the conditions to reduce the cost of trade finance.** Trade finance services are limited and very expensive in Bangladesh. In addition to removing regulations that are an impediment, the Ministry of Finance and Bangladesh Bank should explore the feasibility of creating an Exim Bank to kick start a competitive trade finance market in Bangladesh, following the successful formulas of other countries, including India and China.
- **Board of Investment (BoI) to promote Bangladesh to investors.** The BoI has a critical role to play in promoting the country to investors from high-growth economies, in particular those from China who are looking for more convenient locations for outsourcing their manufacturing. With the right moves, Bangladesh should top their list.

Short- and Medium-Term Economic Outlook

Despite a fragile global economy, opportunities exist for Bangladesh to exploit immediately, as detailed above. However, prosperity cannot be taken for granted; the outlook depends critically on whether Bangladesh successfully seizes the opportunities and manages the risks.

82. **Global growth is projected to increase during 2013.**²⁹ The factors underlying soft global activity are expected to subside. However, this recovery is projected to be gradual. Policy actions have lowered acute crisis risks in the euro area and the United States. But the return to recovery after a protracted contraction is delayed in the euro area. While Japan has slid into recession, stimulus is expected to boost growth in the near term. Policies have supported a modest growth pickup in some emerging market economies, while others continue to struggle with weak external demand and domestic bottlenecks. If crisis risks do not materialize and financial conditions continue to improve, global growth could be stronger than projected. However, downside risks remain significant, including renewed setbacks in the euro area and risks of excessive near-term fiscal consolidation in the United States.

²⁹ World Economic Outlook Update, IMF, January, 2013.

83. **Export product and market diversification as well as diversification of the main migrant labor destination countries would provide the wherewithal for accelerating economic growth.** Experience from other countries suggests that export diversification is associated with generally strong economic performance.³⁰ Some progress has been achieved in this regard (as noted in the Recent Economic Development section above). Current instability in the Middle East and North Africa may have negative consequences on Bangladeshis living and working abroad, which would negatively impact their ability to remit money back home. However, the direct adverse impact seems to be negligible unless the unrest spreads across the Gulf region e.g., Saudi Arabia, the UAE, Bahrain, Qatar and Kuwait. Besides, alternative overseas market—particularly in the East Asia, Europe and Latin America, and also African countries—would help mitigate the problem.

Looming risks will need to be managed with policy dexterity

84. **Recovery in the euro area and United States will be critical for Bangladesh.** The near-term outlook for the euro area has been revised downward. Economic activity is now expected to contract by 0.2 percent in 2013 instead of expanding by 0.2 percent. This reflects delays in the transmission of lower sovereign spreads and improved bank liquidity to private sector borrowing conditions, and still-high uncertainty about the ultimate resolution of the crisis despite recent progress. Risks of prolonged stagnation in the euro area as a whole will rise if the momentum for reform is not maintained. Growth in the United States is forecast to average 2 percent in 2013, rising above trend in the second half of the year. A supportive financial market environment and the turnaround in the housing market have helped to improve household balance sheets and should underpin firmer consumption growth in 2013. The projections are predicated on the assumptions that the fiscal sequester that took effect on March 1 will have a relatively small adverse impact on GDP growth. However, uncertainty generated by repeated failures to reach agreement on US fiscal policy over the medium term could have more significant impacts.

85. **Bangladesh export outlook is also contingent on a possible backlash from the recent compliance and labor safety issues.** The US department of Labor has identified 14 export items—including footwear, leather and shrimp—that are produced allegedly with child labor.³¹ The RMG industry is suffering from a severe image crisis in the international markets because of concerns about labor safety arising from recent fire incidents in two garment factories, which resulted in a combined casualty of 119 workers. This led the US and EU to rethink the Generalized System of Preference (GSP) facilities provided to Bangladesh. The United States Trade Representative (USTR) has started the process of evaluating the GSP facility which might lead to a withdrawal, suspension or limitation of duty-free access.³² Although only 0.54 percent of Bangladesh exports to the US in 2011 was under the GSP scheme, cancellation of the facility might send strong adverse signals about domestic production conditions, and might lead to buyers elsewhere reconsidering Bangladesh as a major source of apparel. Europe, the largest export market of Bangladesh, is also contemplating actions against Bangladesh to ensure full compliance in labor safety.³³ Furthermore, international retail giants such as Walmart³⁴ and Inditex³⁵ are considering a zero tolerance policy and cutting ties with suppliers who are non-compliant (or subcontract to non-compliant factories). EU has revised its GSP scheme which will be in effect from

³⁰ Selected Issues, October 2008, IMF.

³¹ US identifies 14 BD export items child labor link, The Financial Express, January 16, 2013.

³² U.S. Mulls Ending Bangladesh Duty-Free Access, Wall Street Journal, January 21, 2013.

³³ RMG sector's lax safety draws ire of European Parliament, The Financial Express, January 18, 2013.

³⁴ Walmart refuses to take clothes worth \$1 m from Simco Dresses, New Age, January 23, 2013

³⁵ Spanish retailer scraps deals with suppliers having Smart links, The Daily Star, January 30, 2013.

January 1, 2014. Under the revised scheme, although Bangladesh is assessed to benefit most under the “everything but arms” (EBA) category, the textile and apparel exports may suffer heavily.³⁶

86. **Because of the worldwide concern over labor safety and standards, large RMG factories are starting to remove subcontracting from small factories that are non-compliant.**³⁷ In the short term, this might result in some companies not being able to meet shipment deadlines. The government and manufacturer associations have taken some steps to improve the working conditions of workers. The government formed an 11-member cabinet committee, headed by the Labor Minister, to ensure compliance in garment factories.³⁸ They also signed a tripartite agreement with the labor leaders and associations to design an action plan for fire safety.³⁹ The Garment Manufacturer and Exporter Association (BGMEA) cancelled 586 memberships on grounds of compliance and other issues.⁴⁰

87. **Sustainability of the recovery in remittance growth is subject to downside risks because of the uncertainties relating to manpower export prospects.** Processes have been initiated to send workers to traditional as well as non-traditional markets. The government has signed a MoU with Malaysia to send workers under state arrangements.⁴¹ Initially Malaysia requested 10,000 workers,⁴² but 11,758 workers have been primarily selected through online registration and lottery from the seven divisions.⁴³ In addition, Hong Kong signed a MoU to hire 100,000 female workers from April, 2013.⁴⁴ There are also some discussions about sending around 50,000 fishermen to Thailand.⁴⁵ Bahrain expressed interest in taking workers through a government-to-government process.⁴⁶ However, the impact of opening new labor markets can be offset by the closing of traditional destinations in the Middle East. Migrant outflow decreased by 31.8 percent in July-February, fiscal 2013 compared to the same period of the previous year, due mainly to the reduction in manpower exports to the U.A.E, the second largest source of migrants and remittance to Bangladesh after Saudi Arabia. In fiscal 2013 (July-February) due to stringent new visa rules, migrant outflow to the U.A.E was only about 48,000, representing a 77.7 percent decline compared to same period last year. Saudi Arabia still has not opened its labor market to Bangladesh since it stopped recruiting in 2008.

88. **An immediate hindrance to faster economic growth is the unprecedented political complexity in Bangladesh of late.** While increasing violence and political rivalry is not uncommon in Bangladesh as elections near, the recent protests, mainly by youth demanding capital punishment for persons under trial for war crimes, has added a new dimension to pre-election dynamics. The resistance from the opposition has resulted in intermittent violence together with increased frequency of *hartals* (strikes). *Hartals* create an unfriendly and unstable environment for investment by disrupting the production and trading activities and increasing the cost of doing business.⁴⁷

³⁶ Impact Assessment, Vol. 1, Commission Staff Working Paper, European Commission.

³⁷ Sub-contracting apparel units facing closure, The Financial Express, February 2, 2013.

³⁸ Move for cabinet panel for garment factory security, The Independent, January 28, 2013.

³⁹ Action plan by next month, The Daily Star, January 17, 2013

⁴⁰ BGMEA cancels 586 memberships, The Financial Express, January 23, 2013.

⁴¹ KL lifts ban, The Daily Star, November 27, 2012

⁴² 10,000 to get jobs in KL, The Daily Star, January 1, 2013

⁴³ Final lottery held to select 11,758 people, Daily Sun, January 24, 2013

⁴⁴ Recruitment of BD female workers by Hong Kong starts from April, The Financial express, December 27, 2012

⁴⁵ Thailand may recruit 50,000 BD fishermen, The Financial Express, January 23, 2013

⁴⁶ BD starts sending workers to Bahrain from March, The Financial Express, February 26, 2013

⁴⁷ One example is companies reportedly have to pay overtime to workers to show up early and leave late to avoid picket lines.

89. **In the near term, the balance of risks is to the downside.** A further escalation of political tensions and deterioration in the financial condition of state-owned commercial banks pose the greatest risks for growth prospects and public finances. Should these risks metastasize, policy adjustments will be necessary, primarily through exchange rate and fiscal channels. Stronger economic governance will be needed along with fiscal and financial controls to maintain public debt sustainability. At the same time, monetary policy will have to remain sufficiently restrained to contain inflation and maintain reserves.

Bank Support and Results

90. As of March 2012, the Bangladesh portfolio contained 36 projects, including trust funds and newly approved projects with a net commitment of approximately US\$4.5 billion. The portfolio has disbursed US\$499 million (including disbursements made from closed projects) in the first nine months of fiscal 2013. With respect to sectoral composition, two thirds of the portfolio is about evenly split between infrastructure investments (35%) and support for human development⁴⁸ programs (32%); the remaining one third is divided between sustainable development⁴⁹ activities (17%); private sector development/finance engagements (10%); and strengthening public sector / governance systems (6%). The Bank board has so far approved five projects with a net commitment of approximately US\$667 million in the current fiscal year.

91. On a yearly basis, the Country Team uses the CAS results framework as a basis for monitoring progress toward results. The results pillar teams each conduct a workshop to assess whether yearly milestones of progress are achieved and the program is on track to deliver the sixteen expected outcomes by the end of the CAS period. This assessment forms the basis for a joint Government-Bank *Country Performance and Results Review* (CPRR) to which development partners and other stakeholders are invited. This year's Country Performance and Results Review (CPRR) was the mid review of the CAS. took place on January 19 2013. It reaffirmed Bank support for implementation of the government's priorities highlighted in the SFYP. The CAS has four strategic pillars: 1) infrastructure and private sector development; 2) agriculture and disaster management; 3) social service delivery and; 4) governance and inclusion. The CAS results framework defined 16 "outcome indicators" to show what the Bank assistance aims to achieve under each of these pillars by the end of the CAS period, and "intermediate milestones" to help indicate the progress in achieving the results. The CPRR enabled both the government and the World Bank country team to take stock of progress, identify bottlenecks, and chart the way forward for better results.

92. The Bank and the government found progress from the baseline in 76 percent of program indicators, with another 14 percent showing no change and 7 percent showing deterioration. This is an improvement over the previous year, with a notable upswing in data availability for indicators from only 56 percent to an impressive 97 percent. The strongest performance to date has been in pillars 3 and 4, for delivery of social services and increasing empowerment and accountability. Achievement of milestones has been particularly strong in the areas of health and education, as well as the Bank's support for improving public financial management and scaling up community-driven development and women's empowerment initiatives. Other areas where the Bank has significant interventions with improving trends in achieving results include social protection, local government strengthening, and water supply and sanitation. Poor progress toward results is most evident in pillars 1 and 2, and reflects a combination of insufficient government commitment (e.g., investment climate reform), weaker implementation performance (e.g., construction of irrigation and drainage system, new multi-purpose cyclone shelter),

⁴⁸ Education, health, social protection

⁴⁹ Rural development, rural livelihoods, gender empowerment, ICT, etc.

and governance-related modifications in the Bank program that rendered the milestones unachievable (e.g., increased power generation).

Table 3 : Bangladesh Current Macro Economic Indicators

	FY10	FY11	FY12	FY13¹ (Projection)	FY13 (Jul-Mar)	FY12 (Jul-Mar)
GDP Growth (%)	6.1	6.7	6.3	5.8	..	..
Inflation (% y-o-y)	7.3	8.8	10.6	7.2	7.7	10.1
Export Growth (%)	4.1	41.5	5.9	7.2	9.4**	13.0**
Import Growth (%)	5.5	41.8	5.3	2.1	-3.3*	20.8*
Remittance Growth (%)	13.4	6.0	10.2	14.6	16.6	10.7
Reserves (Months of Import)	5.1	3.9	3.3	3.5	4.4	3.2
Exchange Rate (Taka per Dollar)	69.2	71.2	79.1	82.0	79.0**	83.0**
Total Revenue (% of GDP)	10.9	12.2	12.8	13.2	..	..
o/w Tax (% of GDP)	9.0	10.5	10.8	10.9	..	..
Total Expenditure (% of GDP)	14.6	16.3	17.3	17.7	..	..
o/w Current Exp. (% of GDP)	9.7	9.8	10.0	9.7	..	..
o/w Subsidies ² (% of GDP)	1.4	2.0	3.2	3.3	..	..
ADP (% of GDP)	3.7	4.2	4.1	4.7	2.3**	1.9**
Fiscal Deficit (% of GDP)	3.7	4.1	4.5	4.5	..	..
NBR Revenue Growth (%)	18.0	27.6	19.1	18.8	16.1**	17.5**
ADP Spending Growth (%)	31.8	26.7	15.2	35.8	38.1**	23.6**
M2 Growth (%)	22.4	21.3	17.4	17.6	18.7*	17.9*
Growth of Credit to Public Sector (%)	-1.7	33.6	18.8	21.4	12.3*	43.2*
Growth of Credit to Private Sector (%)	24.2	25.8	19.7	16.0	14.8*	18.9*

¹ Projections are based on IMF figures.

² Medium-Term Budget Framework 2012-13 to 2016-17, Ministry of Finance.

All growth rates are year-on-year.

*Till July-Jan of the relevant FY.

** Till July- Feb of the relevant FY

Source: Bangladesh Bank, Bangladesh Bureau of Statistics, Export Promotion Bureau, IMF, and WB staff estimates.